United Nations E/2013/SR.8

Economic and Social Council

Distr.: General
3 June 2013

Original: English

Special meeting on external debt sustainability and development

Summary record of the 8th meeting
Held at Headquarters, New York, on Tuesday, 23 April 2013, at 10 a.m.

President: Mr. Osorio ..... (Colombia)

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The meeting was called to order at 10.15 a.m.

External debt sustainability and development: lessons learned from debt crises and ongoing work on sovereign debt restructuring and debt resolution mechanisms

Opening of the meeting

Opening remarks by the President of the Economic and Social Council

1. **The President** said that it was important to continue supporting institutional capacity-building in developing countries to improve debt sustainability as an integral part of national development strategy. Debt restructuring could have a drastic, adverse impact on economic growth, trade, access to international markets, banks and other international financial institutions. The current crisis differed from previous ones in that problems related to sovereign debt were not confined to emerging markets or low-income countries. Ongoing debt problems in some countries in the eurozone had far-reaching implications for many economies across the world.

2. The issue of sovereign debt restructuring had important implications for the financing of sustainable development and the post-2015 development agenda. Countries in debt distress were generally unable to attract the necessary financing for sustainable development. In addition, countries with debt overhangs often spent a large proportion of public resources on debt servicing and were unable to allocate public revenue to expenditures necessary for sustainable development. To achieve sustainable development, the international community must promote responsible borrowing and lending, along with improved debt management.

Statement by the Secretary-General of the United Nations Conference on Trade and Development

3. **Mr. Panitchpakdi** (Secretary-General, United Nations Conference on Trade and Development) said that it was time to move beyond the attitude that situations could be faced as they arose, without systematic advance planning. Instant solutions had proved lacking in permanent value.

4. The current problems, vestiges of the Great Recession, were related to debt deflation. It would take many years to deleverage all of the debts, and the inflationary impact would be palpable for a long time to come. Fiscal consolidation measures could lead to uncertain, anaemic growth.

5. In the current economic context, sovereign debt sustainability was a monumental issue for the advanced economies. The unwinding and resolution process could have an impact on the rest of the world. Global problems would not go away through the sort of ad hoc arrangements relied upon in the past, such as collective action clauses, Paris Club negotiations, debt relief for Heavily Indebt Poor Countries (HIPC) or Multilateral Debt Relief Initiative (MDRI) arrangements. The debt deflation problems would take a long time to unwind, with rising levels of joblessness and unemployment in advanced economies exacerbating the situation. New financing, investment and capacity-building were needed in the real sectors in order to sort out the financial issues, which could not be resolved through financial means alone.

6. Using fiscal or austerity policy alone to resolve issues of debt, budget deficits and external and domestic debt that exceeded the gross domestic product (GDP) would not be very helpful. The current situation provided an opportunity to determine the extent to which macroeconomic measures provided an effective response.

7. National and household debt were not comparable. The solution to excessive household debt was to save more and consume less. At the national level, however, lower consumption would lead to reduced demand. Producers and investors would then lose their incentive, and debt would not shrink.

8. While the overall picture appeared extremely positive for developing countries, with their total external debt dropping to below 20 per cent of gross national product (GNP), some developing countries were still coping with a rise in the share of their external debts compared to gross national income (GNI) or gross domestic product (GDP). Some developing countries were extending net borrowings so as not to become net lenders. Because some large countries were doing that, the general picture was one of falling debt share and rising international reserves. However, many developing countries still suffered from rising debts and share of debt compared to national income.

9. Allocation of resources by the International Monetary Fund (IMF) was the reverse of what it had

been some years ago. More than half of IMF resources were going to countries in Europe, whereas in the past, more than 80 per cent of IMF resources had been disbursed to least developed countries. International financial restructuring by advanced economies was under way, to guard against possible failures at international financial institutions. Whereas bank balance sheets in the United States had been cleaned up, that was not the case in Europe, which meant that there was a chance of disruption leading to setbacks in Europe and emerging economies.

10. Recovery from recession required macroeconomic policies that stimulated support for debt deflation while simultaneously reducing budget deficits. Stimulus measures that supported restructuring of economic production must be accompanied by cuts to unnecessary government expenditures, including subsidies that could distort trade and prices. Excessive austerity measures might reduce growth without reducing debt. If fiscal imbalances were not addressed, slow growth could continue indefinitely, leaving countries unable to provide additional jobs and productive capacities.

11. Countries tended to underestimate the need for debt resolution. There was a persistent belief that recovery was around the corner and an excessive reliance on piecemeal solutions, such as providing liquidity for the banking system in the hope that it would be able to relend money to the real sector, even if it had not yet cleaned up its balance sheet. Such a solution had never been effective.

12. Countries always waited too long to restructure. That created more economic uncertainties and led to slower growth. Tipping points or time benchmarks should be established, indicating when restructuring must take place, because such efforts made later would be exceedingly costly and time-consuming.

13. Ad hoc debt relief adjustments could work for small economies, but for large and powerful economies that were part of the global locomotive, such adjustments would simply cause economic contractions to go on for years, possibly having a devastating impact on the region or on the global economy. In fact, the banks must be cleaned up promptly. Equity requirements for the banking system should not be postponed.

14. Easing measures were not expected to bear fruit soon. However, spillover of liquidity funds to the rest of the world could lead to some macroeconomic adjustment difficulties in economies that were showing some growth. With developing and emerging economies returning to previous growth rates of 5 to 6 per cent, there might be resistance to a necessary increase in currency exchange rates owing to an influx of funds. Raising interest rates in response might have the effect of killing off initiative. Global solutions must take into account both sides of the issue.

15. Letting the market take care of things, as opposed to a structural approach, could lead to problems, such as lengthy debt negotiations that did not always result in debt sustainability; incentives for some firms to hold out and litigate against countries after settlement had been reached by a majority of debtors; or a lack of access to needed interim funds for countries making adjustments.

16. The lack of seniority structuring led to debt dilution, leaving original lenders less protected, as countries took out new loans without the original lenders receiving seniority status. Cross holding between sovereign sector liabilities and banking sector liabilities created confusion on approaches to restructuring.

17. The United Nations Conference on Trade and Development (UNCTAD) had worked on ways to prevent a recurrence of the debt crisis, proposing a set of principles for responsible lending and borrowing. Both borrowers and lenders must take responsibility in committing to certain loan arrangements.

18. **The President** said that a responsible attitude on both sides was crucial to tackling the problem. Clear and sound management was needed so as not to mortgage the future. Indefinite postponement of solutions must be avoided.

Statement by the Assistant Secretary-General for Economic Development, United Nations Department of Economic and Social Affairs

19. **Ms. Akhtar** (Assistant Secretary-General for Economic Development, United Nations Department of Economic and Social Affairs) said that the global financial and economic crisis and the recent distress in Europe had revealed deep vulnerabilities at the core of the international financial architecture. Delayed defaults and repeated restructurings had been identified as characteristic of sovereign debt markets. While economic models had the tendency to assume that

policymakers defaulted too early or too often, politicians and policymakers usually went to great lengths to postpone what seemed unavoidable. Shying away, however, did not resolve the problem.

20. Defaults were costly, especially in political terms, and that was even more the case if the domestic banking system was in jeopardy. Incentives to gamble for resurrection were high, and, when the bet eventually failed to pay off, costs were typically even higher. Often, additional debts had been incurred that must be repaid, and prolonged uncertainty exacerbated costs. A framework for sovereign debt restructuring could provide incentives to avoid those delays and additional costs.

21. After default was declared, protracted debt renegotiations could erode confidence still further. Even where negotiations facilitated voluntary debt exchanges, the associated economic and social costs were high. For example, there had been cumbersome and protracted negotiations beginning in 2010 and leading to the Greek voluntary debt restructuring in April 2012, but a mere six months later, a further debt reduction operation had been required.

22. Voluntary solutions had generally not provided sufficient debt relief, and debtor countries did not always succeed in bringing themselves back to a path of debt sustainability. Creditors had incentives to give up as little as possible, and debtor Governments in a weak negotiating position sometimes had to settle for less relief than they needed. Rules for debt restructuring could allow faster and more equitable burden distribution, ensuring a return to debt sustainability and sustainable and inclusive growth.

23. The lack of a bankruptcy procedure affected lending, made the market highly inefficient for both creditors and debtors and had an impact on the ultimate cost and extent of borrowing. While a judgment against a sovereign debtor was not necessarily enforceable, claims were not uncommon, even after debt exchanges.

24. A system of rules and procedures would benefit both sovereigns and creditors, diminishing risks and eliminating incentives for vulture funds to gamble in sovereign debt markets. A mechanism for sovereign debt restructuring could help improve coordination and fair representation for the debtor and all dispersed creditors; establish priority rules across the whole range of official and private creditors; provide an early response to debt distress, allowing for breathing space to find a solution and protect from litigation; and provide a space and procedures for dispute resolution. A process was needed that would enable debtors and creditors to address unsustainable situations frankly and in a timely manner.

25. Because bonds were currently held by numerous dispersed bondholders, collective action problems among creditors must be addressed. Collective action clause provisions that established a supermajority were not sufficient, owing to the issue of aggregation across bond issues and different types of debt. A voluntary code of conduct and the principles of stable private capital flows and fair debt restructuring had not resulted in more efficient outcomes.

26. **Mr. Bainimarama** (Fiji), speaking on behalf of the Group of 77 and China, said that the Group attached great importance to the role of multilateral institutions, including those within the United Nations system, in assisting developing countries to achieve and maintain debt sustainability. As stated in the report of the Secretary-General on external debt sustainability and development (A/67/174), the total external debt of developing countries was $4.5 trillion in 2010-2011; the discussions on the need for new sovereign debt restructuring and debt resolution mechanisms were therefore very relevant and should take into account the multiple dimensions of debt sustainability and its role in achieving internationally agreed development goals. However, the growth prospects of many developing countries had been negatively affected by the ongoing financial and economic crises, which had revealed long-standing systemic fragilities and inequalities, leading to a reversal of development trends of the recent past and increased poverty levels. Owing to the limited scope of their economies, many developing countries had been unable to enact fiscal measures to mitigate the impact of those crises on development.

27. The Group was particularly concerned by the high structural fragilities of many developed economies in financing their sovereign debt, resulting from the transfer of private risk to the public sector, and called for urgent and coherent solutions to reduce developed economies' sovereign risk to prevent contagion and mitigate its impact on the international financial system. The methodology used by credit-rating agencies was also a cause for concern, as it did not adequately reflect the solvency of the debtor. It was evident that the agencies had inherent conflicts of

interest and lacked transparency and objective criteria. Furthermore, a very small number of firms controlled a large proportion of the market. Discussions should continue on the role of credit-rating agencies, with a view to producing concrete policies to reduce States' dependency on them, enhance their supervision and adopt more objective criteria to assess credit, solvency and liquidity risks. It was therefore regrettable that once again General Assembly resolution 67/198, calling for a thematic debate on the role of credit-rating agencies in the international financial system, had been ignored.

28. It was evident that exogenous shocks were affecting developing countries' capacity to service their debt obligations. The international community must realize that a path to growth could not be pursued with an unsustainable debt burden. Any debt restructuring exercise should therefore be based on a country's actual repayment capacity; failing to do so could result in further restructuring in the future, affecting growth and creditors' good faith. However, debt restructuring processes and debt sustainability were threatened by the actions of speculators seeking to reap large profits from countries facing excessive debt obligations and repayment schemes. Recent examples of vulture fund litigation in international courts had revealed the speculative and profit-seeking nature of those funds. Such funds must not be allowed to paralyze the debt restructuring efforts of developing countries or to supersede States' right to protect their citizens under international law. When the market-based, ad hoc contractual approach to working out Government debt was insufficient, resulting in litigation and negative impacts on the debt market, States should have recourse to a fair, human-centred, development-oriented mechanism that enshrined the legal principle of odious debt. According to the guiding principles on foreign debt and human rights, endorsed by the Human Rights Council in June 2012, every effort must be directed towards achieving a negotiated settlement between the creditor and the debtor and loan agreements should impose clear restrictions on the sale or assignment of debts to third parties by creditors without the prior informed consent of the Borrower State concerned. The Group urged countries to adopt legislation consistent with those principles to prevent vulture funds from pursuing excessive claims against heavily indebted countries before national courts. Lastly, the Group reiterated its support for the creation of an independent international system of debt arbitration, whereby countries facing debt distress would have recourse to debt standstill and would facilitate debt workouts based on burden-sharing procedures.

Panel presentations on the lessons learned from the history of debt crises

29. **Mr. Lewis** (Director, Economic Policy, Debt and Trade Department, Poverty Reduction and Economic Management Network, World Bank), accompanying his remarks with a digital slide presentation, said that the World Bank and other organizations were looking at past experience of debt crises in an effort to identify the lessons learned. The debt crisis experienced by many low-income countries in the 1990s, as a result of low growth fuelled by poor policies, inadequate debt management and a series of exogenous shocks, had led to a rare international consensus on the need for a comprehensive debt relief mechanism to reduce all debts, commercial, bilateral and multilateral, based on sound policies. The results of that consensus were the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), which had been widely implemented. Considerable progress had been achieved under the HIPC Initiative, with 35 of the 39 HIPC-eligible countries having completed the Initiative. As a result, the external debt stocks of those countries had been reduced by an average of 90 per cent, equivalent to one-third of gross domestic product (GDP) in 2011. The remaining four countries were at various stages of the Initiative owing to the significant economic and political issues they faced. The success of the HIPC Initiative was largely the result of the flexibility that had been built into the system. Although the goals were fixed, its triggers, qualifying criteria, interim debt relief provisions and the point at which the final and irrevocable debt relief was paid were all flexible, in an effort to take into account the different circumstances of individual countries.

30. In addition to those initiatives, the World Bank had hosted the Debt Reduction Facility, which had been created to buy back substantial levels of external commercial debt, not covered by the HIPC Initiative. To date, the Facility had supported US$ 10 billion in buy-backs in 21 HIPC countries and, on average, the buy-back prices on Facility-supported operations had declined and creditor participation rates had remained high. Between 2005 and 2010, the buy-back discount rate had been 96 per cent, which meant that the Facility

had paid US$ 0.04 for every US$ 1 owed, and participation rates had been 98 per cent. It was often more difficult to resolve commercial debt problems as there were many different creditors; however the Debt Reduction Facility had successfully helped to prepare and implement commercial buy-backs with substantial discounts.

31. Although it was harder to prove the causality and additionality of those support mechanisms for HIPC countries, it should be noted that none of the countries that had completed the HIPC Initiative were in debt distress and poverty-reducing expenditures in those countries had increased, on average, by more than three percentage points of GDP, while debt service payments had declined by a similar amount. Debt relief had allowed poor countries to contract new debt, including non-concessional loans, by returning them to a more normal interaction with external capital markets. While it would be a cause for concern if a HIPC country were to borrow excessively or imprudently and failed to invest in measures to enhance economic productivity and growth, it was still too early to ascertain whether countries had made a structural shift to more sustainable borrowing and spending patterns. Low-income countries continued to prefer concessional lending from multilateral financial institutions; however, many of those facilities could not offer sufficient resources. States were therefore turning to non-traditional donors, such as China, or commercial investors, but there was no evidence that those new sources of financing were crowding out traditional concessional loans.

32. Small States were one group that continued to face specific difficulties, characterized by high levels of public debt and slow, variable growth. The small island developing States of the Caribbean had experienced lower average growth than many other developing countries in the region and higher volatility. They were particularly vulnerable to external shocks and deficit and debt problems owing to the greater frequency and magnitude of natural disasters in that region, their limited financial capacity to respond to and recover from those natural disasters, their limited fiscal space for counter-cyclical spending, their high debt service burden, which diverted public resources away from critical social and productive expenditures, and their high debt levels which increased the cost of new borrowing, in turn limiting governments' ability to leverage private investment. He proposed a long-term strategy to reduce small States' debt and promote debt sustainability, based on four pillars, namely accelerating private sector-led growth, improving fiscal management, mitigating the impact of natural disasters on debt and fiscal profiles and restructuring debt portfolios, as necessary. The debts of those States could be restructured using debt buy-back operations or debt swaps, which could be implemented relatively quickly, unless the debt swaps involved assets that had to valued or privatized.

33. The global finance system was changing. Increased reliance on private financing had resulted in a more diverse pool of creditors, who were less amenable to collective action to restructure or relieve debt. While the HIPC Initiative had been successful, it had been costly and cumbersome. Consideration should instead be given to the multiple causes of debt distress and how to ensure fiscal and debt sustainability. Steps should also be taken to prevent debt crises from spreading to other sectors, such as banking. The world economy was now riskier and more volatile, leaving all countries, whether developed, developing or low income, increasingly vulnerable to external shocks. Given the limited appetite for systemic solutions, the best response would be to focus on risk management, debt sustainability, macroeconomic performance and the underlying links between fiscal policies, debt sustainability and growth, by pursuing credible medium-term fiscal and debt management strategies. Countries could thus take steps to avoid the conditions that led to crises. International organizations should also provide capacity building and technical assistance to low-income countries. In that connection, the World Bank now offered client countries Debt Management Performance Assessments, Medium-Term Debt Management Strategies and Debt Sustainability Analysis to support debt management and long-term debt sustainability efforts and initiatives. Similarly, the Debt Sustainability Framework for low-income countries, introduced in 2005, sought to balance States' need to borrow to finance development and the need to maintain sound public finances and a sustainable level of debt, by providing guidance to low-income countries on borrowing decisions and to International Development Associations on lending and grant allocation decisions. It was the first framework that concentrated on the needs of low-income countries, including domestic debt, the links between investment and growth, and remittances. Client countries and development banks were increasingly reliant on the

Debt Sustainability Framework or similar mechanisms, and it was becoming clear that efforts should focus on addressing the causes of debt crises through fiscal and debt sustainability and increased competitiveness. The fiscal risks associated with growing debt at the subnational level, public-private partnerships and guarantees, and contingent liabilities associated with public enterprise debt of a growing number of middle- and low-income countries would have to be monitored. As the range of creditors and instruments expanded, risk management would become increasingly important, as would better monitoring of countries' performances and vulnerabilities.

34. **Mr. Paulus** (Professor, Humboldt University, Berlin), accompanying his remarks with a digital slide presentation, said that the eurozone crisis posed a systemic risk to national economies and politics. The many conferences on sovereign debt sustainability indicated that there was broad consensus on the need for debt resolution framework to be established; it would seem, therefore, that the time was ripe for drafting a legal framework, particularly in the light of the recent ruling by the United States Court of Appeals for the Second Circuit, which had upheld the decision to allow creditors to opt out of Argentina's debt restructuring, and the decision of the International Centre for Settlement of Investment Disputes on the admissibility of the case brought by Abaclat and others against the Argentine Republic, which would probably have negative effects on default avoiding negotiations. The precedents set by those two decisions could lead to serious problems in the future, with creditors refusing to participate in restructurings or vulture funds using it to their advantage. It was therefore surprising that none of the international organizations or financial institutions had calculated the cost of not introducing a regulated mechanism.

35. Discussions on the feasibility of a debt restructuring mechanism had been distorted by the fact that all sovereign States, which had defaulted in the past and had debts restructured under the current ad hoc system, still existed. Unlike commercial insolvency law, there had been no liquidations under the ad hoc sovereign debt restructuring system, which appeared to indicate that a regulated mechanism was not necessary. However, an established legal procedure would have the advantage of giving clear guidance in what was necessarily a chaotic situation. The enormous cost that had been incurred by delaying the restructuring of the Greek economy could have been reduced if a regulated legal mechanism had been in place. Similarly, from an ex ante perspective, the threat of a legal procedure would give additional impetus to preliminary restructuring negotiations. The economic problems in Greece had also revealed that, while collective action clauses were useful in solving debt issues, they did not address the need for economic structural reforms.

36. Pre-default restructuring resulted in lower long-term costs than post-default procedures. In the past, many serious sovereign debt problems had been resolved through pre-emptive negotiations, such as the London Debt Agreement of 1953, which had saved the German economy from bankruptcy in the post-World War II period. He therefore proposed that a legal procedure should be adopted that incorporated both contractual and negotiated approaches to debt restructuring. Any mechanism should be sufficiently flexible to allow for alternative approaches to avoid or manage sovereign debt crises. Tools such as collective action clauses could still play a role in a debt workout mechanism. In that connection, the work of the United Nations Conference on Trade and Development (UNCTAD) on responsible sovereign lending and borrowing was welcome.

Panel presentations on the ongoing work on sovereign debt restructuring and debt resolution mechanisms

37. **Ms. Li** Yuefen (Head, Debt and Development Finance Branch, United Nations Conference on Trade and Development) said that it was natural that concerns persisted about creating a debt restructuring mechanism, as there were various legal, economic and political hurdles that had to be overcome and ad hoc mechanisms had been used for decades. Collective action and aggregation clauses had been introduced following the rejection of a proposed sovereign debt restructuring mechanism over fears that it would make it easier to restructure sovereign debts, something many considered to be morally hazardous. However, a comprehensive mechanism would make debt restructuring more timely and fair and restore debt sustainability, thus reducing the cost of such crises.

38. Various reports prepared by UNCTAD over the last four decades, including the annual Trade and Development Reports, had repeatedly examined the question of a debt restructuring mechanism. The precipitation of the global financial crisis had lent

added urgency to the question of a debt resolution mechanism and UNCTAD had been one of the first to reopen discussions by co-hosting a high-level seminar on debt crisis resolution with the Initiative for Policy Dialogue in February 2011. While the weaknesses of the current system had been highlighted at that seminar, about one-third of the seminar participants had been of the view that the ad hoc system had worked well and that collective action clauses and debt exchanges were sufficient to solve both the creditor coordination problem and the need for new financing. In order to further debate on the issue at international, regional and national levels and to build international consensus, UNCTAD, with the Department of Economic and Social Affairs, had organized a special event of the Second Committee on "Sovereign debt crises and restructurings: lessons learnt and proposals for debt resolution mechanisms" during the sixty-seventh session of the General Assembly. Furthermore, in an effort to expose the gaps in the current system, allay fears and explain how the mechanism would function, UNCTAD had been participating actively in meetings organized by various stakeholders. As a result of the mounting debt problems in the eurozone and the recent ruling by the United States Court of Appeals for the Second Circuit, many experts were now calling for an ex ante debt workout mechanism, with clear rules and procedures, arguing that it would be less costly and would introduce greater economic and political efficiency than the current ad hoc process. That shift in opinion had been palpable at the recent UNCTAD brainstorming meeting on a debt workout mechanism held in February 2013. Moreover, the absence of a legal forum for the resolution of debt crises had led to decisions being taken at a local level, at the expense of global coherence. The current ad hoc approach entailed lengthy debt renegotiations, which had failed to restore debt sustainability, delayed defaults, failed to provide access to private interim financing, resulted in overborrowing as a result of debt dilution and required greater coordination of the interests of dispersed creditors. Unfortunately, those problems had been further exacerbated by recent economic and financial developments.

39. The work of UNCTAD on sovereign debt restructuring and resolution mechanisms included a parallel examination of debt crisis prevention and resolution, based on the mandates given in the General Assembly resolutions on external debt and by the quadrennial UNCTAD ministerial conferences. Those debt crisis prevention and resolution efforts were underpinned by validated debt data, gathered through debt data analysis, intergovernmental and expert deliberations and consensus building, and technical assistance carried out by UNCTAD in some 60 countries. The UNCTAD initiative financed by Norway, to develop principles to promote responsible sovereign lending and borrowing, included specific recommendations on debt restructuring. The second phase of that project, to examine the feasibility and possible design of a debt workout mechanism, had begun in January 2013, with the participation of internationally renowned experts and relevant institutions. Any mechanism should preserve the balance between creditors' rights and incentives to lend and a timely debt restructuring that was fair and efficient. Similarly, discussions on a possible mechanism should be circumspect, inclusive and transparent, if the work of UNCTAD was to bear fruit.

40. **Ms. Schneider** (Senior Economic Affairs Officer, Financing for Development Office, United Nations Department of Economic and Social Affairs) said that her Office had organized expert group meetings to discuss possible improvements in the IMF debt resolution architecture, and had identified a number of shortcomings.

41. The architecture had not been reformed to take account of the shift in the global economy from closed to open capital accounts and the predominance of private over official capital flows. The bailout for the resolution of the Greek sovereign debt crisis had been the largest ever, and the official sector would not be able to loan such amounts to States in future; rather, the private sector would need to provide debtor-in-possession financing, which was currently impossible.

42. The architecture should make provision for standstills, through which States could cease loan payments pending the negotiation of a restructuring agreement. To that end, either article VIII.2 (b) of the IMF Articles of Agreement could be amended to allow for standstills on capital transfers, or standstill agreements could be voluntarily incorporated into loan contracts.

43. The expert groups were also discussing the use of restructuring and new financing to address unsustainable debt, in addition to domestic policy adjustments through fiscal contraction and exchange rates. The lack of a platform for early engagement

between debtors and creditors, and in particular for establishing the relationship between the private and official sectors, led to uncertainty in the event of debt crises. Rules, and particularly debt restructuring mechanisms, should be put in place to enable such engagement. Under the existing architecture, IMF could not force creditors to accept restructuring if a State's debts became unsustainable. As a result, it was obliged to exercise forbearance even where the State was likely to become insolvent.

44. The current need for debt restructuring while the banking system was highly leveraged meant that in the event of a crisis the official sector was forced to decide whether the top priority was to bail out the banks in the affected State or address the State's fiscal situation. The decision was complicated because debt write-downs had implications for the expansion of credit. In the case of Greece, the banks had been bailed out first; by the time the country's debt had been restructured, the debt burden had greatly increased.

45. The situation held moral hazards for all actors, leading debtors to defer necessary adjustments in the hope that economic conditions would improve. Lenders priced incorrectly, and banks might postpone the recognition of losses on their balance sheets. Reform was needed because the costs of sovereign debt restructuring were very high, resulting in output losses, trade losses, reduced access to external credit, higher spreads, more financial instability, less foreign direct investment and lower credit ratings.

46. In the wake of the debt crisis, creditors felt that their rights had been eroded. They were concerned by the behaviour of certain debtors and were affected by the preferred creditor status of IMF and the European Central Bank. Debtors were concerned by the delays in the delivery of debt relief, the insufficiency of such relief, which would lead to future restructuring, the threat to the resumption of growth, hold-outs and litigation and the lack of access to finance.

47. The architecture lacked a centralized dispute resolution mechanism and organized representation of all stakeholders. It suffered from shortcomings relating to priority and equity among creditors and between the private and official sectors.

48. It had emerged from the expert group meetings that IMF should have a clearer role in relation to capital inflows because, in a context of rising risk premiums, financing from the official sector led to an exit of capital. Voluntary collective action clauses, which had replaced the SDRM, were insufficient. Although they helped coordination among the creditors of a single bond issue, they were not effective against problems affecting various bond issues. They could not overcome all of the architecture's shortcomings or act as a substitute for public policy. Voluntary codes of conduct had proved ineffective against rising risk premiums and low growth.

49. The potential solutions discussed in the expert working groups included committees with oversight bodies and governance structures to ensure ex-ante coordination among creditors; contractual and statutory standstills; debtor-in-possession financing; and an international debt registry to record complete and timely data, which were currently lacking. A balance should be struck between voluntary and statutory proposals.

50. More research was needed into the interaction between regulatory, tax and accounting regimes, which currently tended to discourage debt write-downs. The Basel Accords had introduced binding lower limits to restrict the use of capital provisioning to facilitate such write-downs. Losses and the approach taken to them had serious implications for systemic risk and bank stability. Coherence was needed between the official lending system and the banking rules being developed, to ensure that the accounting and regulatory regimes would not prevent early restructuring.

51. The official sector needed to find a balance between the voluntary and statutory approaches to debt restructuring. A possible solution was a system similar to the World Trade Organization (WTO) dispute resolution mechanism, with a first stage comprising time-bound voluntary negotiations. If the negotiations failed, a panel of experts could serve as an arbiter, also with a deadline. In a third stage, a panel of judges would enforce a binding settlement. Such a system would introduce judicial sanctions into the voluntary debt restructuring process. An alternative was the mechanism set out by Mr. Paulus in his statement. A third option was the formation of a neutral body which would engage debtors and creditors with a view to enabling debt restructuring.

Interactive dialogue

52. **Ms. Elsayed** (Sudan) said that her Government was now eligible for debt relief under the HIPC, as discussed at the 2013 Spring Meetings of the World

Bank Group and IMF. Under the September 2012 Comprehensive Cooperation Agreement, it had assumed the debt of South Sudan in addition to its own, on condition that it obtained debt relief within two years. Such relief was essential not only to development but also to the security and future of the Sudanese people.

53. **Mr. Moulton** (South Africa) said that the economic crisis had threatened debt sustainability. The total external debt of developing States had increased from $3.5 trillion in 2009 to $4.5 trillion in 2010-2011, and would lead to cuts in public spending. Moreover, the transfer of private risk to the public sector threatened the stability of many developed economies. Sovereign debt should therefore be refocused through debt relief, cancellation and restructuring.

54. The results of previous attempts at such restructuring had been mixed; the SDRM had failed because of a lack of support from stakeholders. In reforming global financial governance to avoid future crises, the international community should ensure debt sustainability and devise policies which took account of national sovereignty and country-specific conditions.

55. Discussions on the UNCTAD Draft Principles to Promote Responsible Sovereign Lending and Borrowing should continue. The HIPC initiative should be fully implemented and international financial institutions should review debt relief programmes to understand why some countries continued to face debt problems after receiving HIPC relief.

56. South Africa was the headquarters State of the first centre for African public debt management, which aimed to encourage cooperation among debt managers, the development of good practices and the implementation of stronger infrastructure for Government securities markets.

57. **Ms. Chen** Yingzhu (China) said that the financial crisis had increased the debt burden on developing States. The international community should do more to reduce that burden by establishing a debt restructuring system. Developed States should honour their debt relief commitments; they and international financial institutions should provide more assistance and technical support to developing States while respecting national sovereignty and development strategies.

58. **Mr. Lecompte** (Jubilee USA Network) said that a consensus was growing among investors, IMF and the World Bank that the behaviour of vulture funds was cause for concern. He commended the Government of the United States of America for filing a friend-of-the-court brief in the case of NML Capital Ltd. v. Argentina to prevent the outcome of those proceedings from adversely affecting low-income States. The international community should use the emerging consensus to develop a single debt resolution process involving all creditors, comprising impartial decision-making and an assessment of the validity of claims. Such a process was essential to ex-ante regulation of vulture funds.

59. **Ms. Hanfstaengl** (Bread for the World) said that procedures for re-establishing solvency should ensure that all creditors were involved in debt restructuring. The validity of claims should be impartially assessed; her organization had criticised the original SDRM proposal of IMF in 2001 because it had not provided for such impartiality.

60. Such procedures should offer incentives for creditors to provide temporary financing in order to relaunch the economy of debtor States. Debt sustainability criteria should be based on human rights and include a social protection floor. They should require creditor haircuts, for which no provision was currently made.

61. Her organization welcomed the establishment of the UNCTAD working group on the examination of a possible debt restructuring mechanism, which should examine the reforms proposed by the United Nations, international financial institutions, academia and civil society, and coordinate the global dialogue on the adoption of a sovereign debt mechanism.

62. **Mr. Schuldt** (Ecuador) said that the debt problems faced by certain States even after restructuring under the HIPC MDRI called into question the effectiveness of the initiative, which had been designed by a specific group of countries as a temporary mechanism.

63. Another shortcoming of the current architecture was that no transparent and independent debt restructuring mechanism existed for middle-income countries. The SDRM would have constituted such a mechanism. Restructuring could be achieved either through a statutory approach or a voluntary one comprising enhanced corrective action clauses. Pending such restructuring, however, financing, temporary moratoriums, agreements and a forum of debtor countries were needed to avoid the problem of vulture funds.

64. If the Council's current dialogue on debt restructuring were continued on a regular basis, an appropriate forum would be needed for discussions within the United Nations involving international financial institutions and the private sector with a view to exchanging information, identifying solutions and finding political common ground.

65. **Mr. Lewis** (Director, Economic Policy, Debt and Trade Department, Poverty Reduction and Economic Management Network, World Bank) said that efforts were being made within the framework of the HIPC initiative to help the Government of the Sudan define its macro framework and prove its eligibility. His staff had discussed the matter at the 2013 Spring Meetings of the World Bank Group and IMF, and the Bank would continue to strive for the provision of debt relief to the Sudan.

66. Debt distress persisted in certain States which had received relief under the HIPC initiative because the thresholds above which debt was considered unsustainable in the HIPC system were higher than those above which a State was classed as being in debt distress within the IMF and World Bank debt sustainability framework for low-income countries. A State could therefore pass the HIPC completion point and continue to be in debt distress within the IMF and World Bank framework.

67. That framework also took account of Governments' debt management capacity; a low-capacity State was considered at greater risk of debt distress than a high-capacity State with the same level of debt.

68. More fundamentally, the World Bank needed to understand the challenges facing States in choosing from the array of borrowing options now available to them, including bonds and loans from non-traditional donors.

69. **Mr. Paulus** (Professor, Humboldt University, Berlin) said that debt relief was essential to crisis prevention, and that a legal deterrent was needed to instil discipline among borrowers and lenders. Ideally, the sanctions provided for under such an instrument would never be implemented. Although the filing of the friend-of-the-court brief in the case of NML Capital Ltd. v. Argentina was an interesting development, it posed a grave threat to the financial capital market of New York. Temporary debt moratoriums were desirable but would be difficult to apply worldwide, since certain courts might ignore them.

70. **Ms. Yuefen Li** (Head, Debt and Development Finance Branch, United Nations Conference on Trade and Development) said that she was encouraged by the emphasis during the interactive discussion on the negative impact of the financial crisis on the debt burden of developing States, whose domestic borrowing at short duration and external private borrowing had risen. When the current expansionary monetary policy came to an end, the debt burden on such States would only increase.

71. She welcomed delegations' support for the UNCTAD Draft Principles to Promote Responsible Sovereign Lending and Borrowing. Creditors and borrowers should remain accountable and act responsibly.

72. Her Branch would continue to examine the feasibility of the debt restructuring mechanism with stakeholders from civil society and multilateral financial institutions.

73. **Ms. Schneider** (Senior Economic Affairs Officer, Financing for Development Office, United Nations Department of Economic and Social Affairs) said that the Council should discuss the conditions under which debt could be an important source of financing for sustainable development. Since voluntary approaches had proved ineffective in the face of crises, a structure of incentives and disincentives was needed to foster responsible borrowing and lending and stop high debt burdens from impeding growth and poverty reduction.

74. The interactive dialogue had revealed consensus on the existence of shortcomings in the debt resolution architecture, but more discussion was needed in order to make progress on the various proposals. In relation to the forum for debtor States mentioned by the delegation of Ecuador, the Government of Brazil had proposed such a forum for the joint negotiation of Latin American debt before the implementation of the Brady Plan, but the scheme had not been approved. Such a forum would, however, facilitate the exchange of information.

75. She had received a proposal for the establishment of a standing committee to facilitate consensus-building within the private sector, following which round tables could be organized through the United Nations to seek common ground with the official sector. She would welcome further proposals from Member States.

The meeting rose at 12.55 p.m.